The success of our products ultimately will be measured by the people who use them.

MICROSOFT CORPORATION 1992 ANNUAL REPORT

(In thousands, except net income per share)	Year ended June 30				
	1992	1991	1990	1989	1988
For the year					
Net revenues	$2,758,725	$1,843,432	$1,183,446	$803,530	$590,827
Net income	708,060	462,743	279,186	170,538	123,908
Net income per share	2.41	1.64	1.04	0.67	0.49
Return on net revenues	25.7%	25.1%	23.6%	21.2%	21.0%
At year-end					
Cash and short-term investments	$1,344,901	$ 686,314	$ 449,238	$300,791	$183,225
Total assets	2,639,903	1,644,184	1,105,349	720,598	493,019
Stockholders' equity	2,192,958	1,350,831	918,563	561,780	375,498

FINANCIAL HIGHLIGHTS

Net Revenues
(In millions)

Net Income
(In millions)

Net Income Per Share

A LETTER TO OUR SHAREHOLDERS

William H. Gates,
Chairman of the Board and
Chief Executive Officer

Whether measured in revenues, or product introductions, or industry reviews, or customer satisfaction, or just simply in the enthusiasm of our own employees, this has been a great year for Microsoft.

It has also been a year of change. In February, we made the decision to reshape our organization, structuring the Company into three major groups—Products, Sales and Support, and Operations—reporting through the Office of the President. This new structure has allowed us to work more efficiently and provide the best possible support to customers, while encouraging people across the Company to think and work more globally.

Software is an industry sparked by innovation and fueled by change. The pace of change is exceptionally rapid: most of the products released before 1990 are already outdated. And the methods for selling those products have changed as well, requiring us to be as forward-thinking about marketing as we are about products.

In this report, we'll introduce you to several people who have entrusted their organizations to Microsoft-based solutions. Together with them, we're creating a bold vision of the future, built around software that's approachable and powerful, and which sets the stage for putting enterprisewide data into the hands of the people who can use it most—what we call Information At Your Fingertips.

William H. Gates

Spurred by the success of the Microsoft Windows operating system and applications for Microsoft Windows, the Company has posted record earnings.

Revenues for the past 12 months equaled $2.76 billion, a 50% increase over the $1.84 billion recorded in fiscal year 1991.

Net income reached $708 million, up from $463 million last year, an increase of 53%. Net income per share rose 47% to $2.41, compared with $1.64 last year (restated to reflect a three-for-two stock split in June 1992).

Products Group. In the most active year in our 17-year history, Microsoft introduced 48 new products, including well over 100 international versions.

Michael J. Maples, Executive Vice President

Key among these was Microsoft® Windows™ operating system version 3.1. Now running on more than 10 million systems, Windows has become the fastest-selling graphical user interface ever. It has been a phenomenon unmatched in the history of our industry, driving both hardware and software sales for Microsoft and for the hundreds of other companies that have developed products for Windows.

Windows is at the core of our strategy, providing the foundation on which we are developing our family of applications products. During the year, we upgraded the Microsoft Excel spreadsheet, Microsoft Word word processing program, Microsoft Project business project planning system, and Microsoft PowerPoint® presentation graphics program.

Each of these introductions represents a significant upgrade, recognized by the industry as an advance in the "state-of-the-software" art. Later in this report, we will discuss the model of software development that drove our decision processes for these and other products.

We also introduced the first of our Microsoft Solution Series of products for Windows, which are entry-level software programs for small business and first-time computer users: Microsoft Works productivity tools, Microsoft Publisher desktop publishing program, and Microsoft Money financial organizer.

Together with the success of Microsoft Windows, our pointing device products continue to do well. Microsoft Mouse and Microsoft BallPoint® mouse complement Windows by giving people an easy way to select text and commands.

The success of Microsoft Windows has not been limited to the United States. In view of the international acceptance of Windows, we simultaneously released Windows version 3.1 in English, Dutch, French, German, Italian, Spanish, and Swedish. We are a global company in an increasingly global industry, and our ability to ship products simultaneously in multiple languages gives us a competitive advantage.

While Windows is important to the Company, we have also committed significant resources to the growth of other product lines. For example, we updated most of our programs designed for Apple® Macintosh® systems, including Microsoft Excel, Word, Microsoft Project, and Mail.

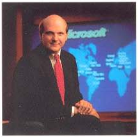
We also upgraded Microsoft SQL Server, our intelligent network database server, to version 4.2. And we merged with Fox Software of Perrysburg, Ohio, which will make it possible for us to offer a complete family of superior database applications across different computing platforms. In addition, we produced Microsoft C/C++ version 7.0, an object-oriented language for professional developers.

And Microsoft Press, our publishing division, now offers more than 100 titles in 15 languages, with 60 new titles released during the last fiscal year.

In short, the Company completed the most active year in our history with a strong product line and the belief that we can strengthen it even more through a commitment to making it easier for our customers to do more with personal computing.

Sales and Support Group. Every day, Microsoft employees are on the front lines with many different kinds of customers: distributors, hardware manufacturers, software vendors, major resellers, and users in business, government, education, law, and home settings.

To serve this broad range of customers and to maintain long-term relationships with them, we've built a product support organization of 2,000 people, answering 4.6 million phone calls last year (more than 26,000 a day). In the process, we've become faster, too, with 70% of all callers getting help in less than 60 seconds.



Steven A. Ballmer,
Executive Vice President

We've also aggressively sought ways to meet the complicated requirements of the people who select our products. For example, Microsoft Consulting Services (MCS) works with customers worldwide to help them develop sophisticated business solutions that take advantage of the scalability, networking capabilities, applications, and other tools available with Microsoft Windows. And Microsoft University (MSU) provides the technical education and training needed by corporate information systems managers, developers, and support professionals to build and support their business solutions with Microsoft systems products.

In short, we've done our best to make it easy to do business with Microsoft. But we know we can do more. Over the next year, we will continue building our support organizations to mirror the needs of our growing base of customers. We plan to increase emphasis on building relationships with large corporate accounts, so they can look to Microsoft as their central source for help with computing decisions. We'll invest in international expansion, while closely monitoring domestic expenses. And we'll enhance our sales and marketing efforts, while looking for intelligent ways to control sales and marketing costs without sacrificing quality.

The Company is at one of the most exciting crossroads in our history. Through attention to serving our customers and an ongoing commitment to factoring customer input into product development and support decisions, we will help ensure the highest success of our products and the Company.

Operations Group. How is Microsoft able to release such a large number and variety of products year after year?

In part, it's because of our size and scope. The Company currently employs 12,000 people in 27 countries around the world.

The Windows 3.1 product launch was the largest mobilization of resources in the history of the Company. Among other activities, we trained more than 10,000 computer resellers and consultants. In the first three months, we educated more than 85,000 users at 350 seminars in 200 cities. We reached about 1.6 million registered users of Windows with the Focus on Windows *newsletter. And we launched our first-ever TV advertising campaign. But perhaps most impressive is the fact that more than one million units of Windows 3.1 were on store shelves even before the product was officially announced.*

In part, it's because of how we've organized our business. We maintain an entrepreneurial spirit by working in small, self-sufficient groups that are designed to empower our employees. For example, in our state-of-the-art manufacturing facilities, we have replaced traditional manufacturing lines with quality-focused roundtables, where each individual has greater responsibility for the finished product.

Francis J. Gaudette, Executive Vice President; Chief Financial Officer

In part, it's because of our commitment to streamlining operations where possible, using our own technologies to plan, collect, and distribute key information companywide. The Microsoft corporate network—with more than 20,000 personal computers linked through 3,330 miles of cabling as well as international extensions—allows people across the Company to stay in close, constant touch with the information they need to do their jobs.

And in a very large part, it's due to the people who have chosen to work at Microsoft, people who consistently demonstrate their talents, their excitement, and their dedication to the Microsoft vision.

Even with these strengths, we still expect to face challenges next year. For example, we expect rigorous competition in many markets. And we are continuing to invest for the long-term in our products and product groups, in our sales channels, in the marketing of our products, and in productivity tools. While our net income as a percent of revenues increased each year for the last nine years, because of factors such as the above, we do not expect to be able to continue this improving trend.

We do look forward confident in the knowledge that our customer base is growing, our understanding of how to deliver world-class products is better than ever, and—most important of all—our vision is intact.

MICROSOFT WINDOWS

In just two years, more than 10 million people have adopted Microsoft Windows. That's a new customer every 10 seconds.

In the time it takes to read this page, two more people will have made the move to the Windows operating system. And by the time the day is through, another 5,000 will have installed Windows on their machines.

Windows is, quite simply, the fastest moving, most successful product in the history of the personal computer business. As evidenced by the fact that we shipped more than three million copies of version 3.1 to customers in the first six weeks after its introduction.

Our industry has never seen anything like it. The phenomenon of Microsoft Windows has brought new energy to the software and hardware business. It has inspired a new generation of intuitive products that let people use computers in a more natural way, carrying information from one program to another and sharing data from one desktop to another.

And it has demonstrated the truth of what we predicted a decade ago: that a graphical user interface, such as Microsoft Windows, represents the future of computing.

Since the introduction of Microsoft Windows version 3.0 on May 22, 1990, more than 5,000 commercial applications have been developed for it, with hundreds more arriving every month. More than 85 hardware companies now preinstall the Windows operating system on their machines, carrying the Microsoft Windows Ready-to-Run logo to indicate that Windows comes as standard equipment.

MICROSOFT®
WINDOWS™
READY-TO-RUN

And that's just the start.

Over the past year, we upgraded to Microsoft Windows version 3.1, making hundreds of enhancements in areas such as file management and overall performance, and by adding TrueType® font technology. At the same time, we created major customer-oriented programs to smooth the transition to the new version and ran our first national television advertising campaign.

The results? In six weeks, we shipped three million copies of the new version.

Windows will evolve to fit the needs of a growing, changing market. It can serve as the foundation for *multimedia computing*, mixing video, animation, and sound. And it can serve as the foundation for *pen computing*, which lets people control their computers by writing on a tablet with a pen-like stylus.

During this fiscal year, the Company plans to introduce the Microsoft Windows NT™ operating system, a high-end, 32-bit version of Windows that can allow Windows to become the operating system of choice in mission-critical settings, such as on servers and in the most demanding data environments.

Brian Lovelock, Chief Information Officer, Information Technology Group ►

Robert G. James, General Manager, Information Technology Network Products

As a strategic component in Telecom Australia's Standard Operating Environment (SOE), Microsoft Windows plays a central role in establishing an integrated platform for desktop computing.

Telecom Australia

As the main supplier of phone services across the vast Australian continent, Telecom Australia has standardized on Microsoft solutions for Windows on more than 25,000 desktops.

CIO Brian Lovelock notes: "Information technology is fundamental to our business. Standardizing means we can operate efficiently and spend time developing our business instead of investing resources to bridge isolated systems."

"We are the largest buyer of computers in the Southern Hemisphere," observes Robert G. James. "We selected Microsoft because we recognized very early that Windows 3.0 would be a significant technology. Microsoft also had good products in every category, offered close integration across the platform, and was willing to show us where they were going."

The solutions using Windows complement Telecom's advanced voice and data facilities, which process 3.5 million transactions daily. To handle this load, Telecom is moving toward distributing data in the field while allowing for the centralized storage of key information.

"The desktop is just the beginning," says Lovelock. "Computing and communications are converging. Our agreement with Microsoft means we can make our employees more productive and focused on serving customers."

APPLICATIONS FOR MICROSOFT WINDOWS

Not too long ago, the only way a person could use a personal computer was to learn a lot of daunting, almost secret codes that were different for every program.

But that's history.

Now, with applications designed for Microsoft Windows, people can take control of their machines.

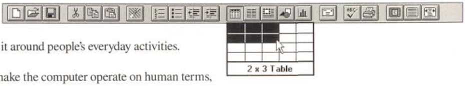
Part of that power comes from the design of Windows itself. With pull-down menus, on-screen buttons, and common commands, all applications for Windows work about the same way.

But even though all of these programs share a Windows-based interface—making them easier to learn and use—they're not exactly the same. When programming for Windows, each software developer is free to create applications that push the environment's potential.

To develop programs that reach beyond the standard, Microsoft's developers of applications for Windows have recognized the most essential element in the formula:

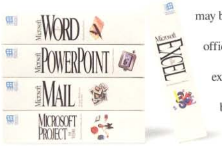
The customer.

Over the past couple of years, Microsoft has developed a dramatically new, customer-based model that defines how we develop products. We call it "activity-based software," because it simplifies software by designing it around people's everyday activities.

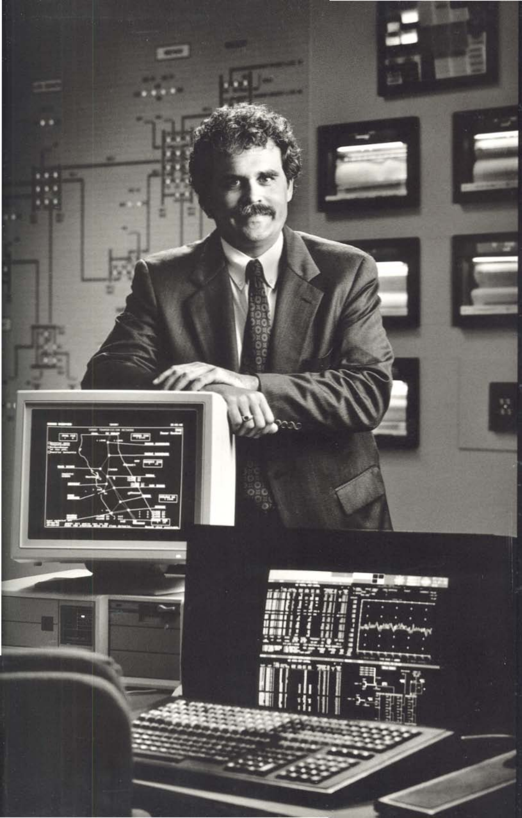


In essence, we make the computer operate on human terms, so it can anticipate what you want it to do. For example, when you type "Jan" in our Microsoft Excel spreadsheet and click one button on the screen, it will correctly fill in all the names of all the months. Or when you instruct Microsoft Word to show a "Ribbon" and "Ruler" on-screen, it displays buttons that give one-click access to the most frequently used commands, such as changing type fonts or setting tabs.

Making this activity-based model work is a tremendous accomplishment. Working with a core group of people, we produce instrumented versions of our products that keep track of every individual keystroke those customers make, and then we examine the data so that we can learn exactly how people use our products. We carefully maintain data from our customer support phone lines to understand better what problems customers may be facing. We follow products back to the office with typical customers, tracking their experiences from the time they first open the box to when they become proficient with the software. And we do extensive testing in our usability labs, where we experiment with alternative prototypes of our products to find out what really works and improves the product. All this adds up to making it easier for people to get the most possible power out of the software they use every day.



Arthur W. Beckman, Manager, Information Technology Services ▶
Charged with the mission of developing and promoting an integrated office strategy for PG&E, the company's ITS group has embarked on Windows-based solutions across the organization.



Pacific Gas and Electric Company

"I had one of the first personal computers here at PG&E," remembers IT Manager Art Beckman. "Just a couple of years ago, if you called a meeting to talk about PC technology, only a handful of people would show up. Now, there are four or five hundred."

In line with this rapid pace of change, people across PG&E are adopting Microsoft Windows in large numbers. "Our organization promotes a user-centric view of computing," notes Beckman. "We had developed a three-year plan to move 18,000 desktops to Windows. In the first few weeks, we hit our first-year target of 4,000."

Adoption of applications for Windows was just as quick. "We believe technology should empower people to get their jobs done," says Beckman, "but you can't empower people in a character-based environment. We've seen that the graphical environment really does give people an easier, more consistent way to work.

"What's more, the 'office environment' here extends beyond the four walls of our building. We've got people in trucks; we've got people in the field. And we have customers and suppliers who could eventually link in to our system. When you put power on the desktop, you create changes that can ultimately affect the entire organization."

APPLICATIONS FOR MACINTOSH

When Apple Computer introduced Macintosh in January 1984, Microsoft was there, as the first major software company to develop a line of applications for it.

A lot has happened since then.

By introducing products such as Microsoft Word, Microsoft Excel, and Microsoft Works, we believe that we have contributed in significant measure to the success of Macintosh.

And our commitment of resources to Macintosh continues to be substantial. We have always supported, and will continue to support, those customers who select Macintosh as their system of choice.

Most important, we have also long recognized that no computer is an island—that Macintosh systems are often used in mixed-machine environments. To that end, we have ensured that our products for Windows and Macintosh can share data. Our goal is, quite simply, to help our customers use whatever types of systems make the most sense for their organizations, running Microsoft-based solutions that will help make them more productive and more efficient.

Naval Air Systems Command (NAVAIR)

As the business, research, and engineering arm of the U.S. Navy responsible for all naval aircraft, NAVAIR's information technology needs are as sophisticated, and diverse, as the equipment they support.

"We determined there were two ways to integrate our information environment," notes MIS Director, Commander Craig Luigart. "Make sure everybody got the same machine. Or make sure everybody could use the same data. We believe in the data approach. By ensuring that programs can exchange data, and by adopting compatible suites of applications such as The Microsoft Office for Macintosh and for Windows, we can let users select whatever hardware platform best meets their needs."

"Coexistence is key to us," agrees Deputy Director Ron Turner. "Across NAVAIR, we have a mix of machines. With more than 5,000 Macintosh systems, our China Lake facility is one of the largest Mac® sites in the world. While here at headquarters, PCs outnumber Macs two-to-one. That's why we evaluate any vendor's software based on cross-platform, cross-network compatibility."

"With Microsoft applications, we're able to use the same files without knowing which platform they were created on," says Luigart. "It's part of how we're re-engineering our organization to work smarter."

To succeed in a highly competitive industry such as the software business, a company must constantly challenge existing assumptions, grow new product lines, and explore the leading edge of technology.

Microsoft's early decision to develop products for Apple's Macintosh computer was just that kind of smart choice, even though at the time, many considered it a high risk. But that decision has paid off through ongoing sales of software products for Macintosh, which continue to be a significant revenue source for our Company.

Over the past year, we've put a lot of effort into the Macintosh side of our business. We were the first company to ship a spreadsheet and a word processor to work with Apple's new System 7™ operating system, incorporating features such as voice annotation, Balloon Help™, and Publish and Subscribe. We introduced new products for Macintosh, including Microsoft Project and Microsoft Schedule+. In addition to updating Microsoft Excel and Word, we came out with new versions of our Mail, Flight Simulator®, and The Microsoft Office products for Macintosh. And we've made it possible for customers to exchange files between Macintosh and MS-DOS®–based

systems, giving users in mixed environments maximum flexibility with minimum hassles.

Recently, we also reaffirmed our long-term commitment to Macintosh by announcing our intention to develop applications for the next-generation Macintosh, the PowerPC™.

In short, we have always been — and we remain — committed to the Macintosh platform as an important part of our product mix.

Commander Craig B. Luigart, Director, Management Information Systems ►

NAVAIR's total-quality approach to information management, coupled with the ability of Microsoft applications to share data across platforms, makes it possible for users to work on whatever hardware they want.

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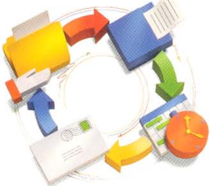
WORKGROUP COMPUTING AND NETWORKING

Twenty years ago, most people in the computer business envisioned a minicomputer-focused or mainframe-centric world that would provide the foundation for corporate productivity.

But the proliferation of desktop personal computers has forever changed how people think about computing. Today, that classic model of the computing future has been replaced with the image of workgroup-based users—smaller, department-sized groups of people who share common goals and common needs—working within a broader corporate setting.

This means that individuals, empowered by PCs, not only can share information and resources among themselves, but can also reach beyond their departments and efficiently use centralized corporate data.

Serving both these needs—at both the individual and enterprisewide level—is central to the direction of Microsoft computing over the next 20 years.



Although there isn't yet a computer on every desk in every office, more people in more companies rely on their computers than ever before. With the ever increasing value of information and dependence on computers to collect and analyze that information, the companies we work with need fast, accurate, and secure ways to get data to their employees.

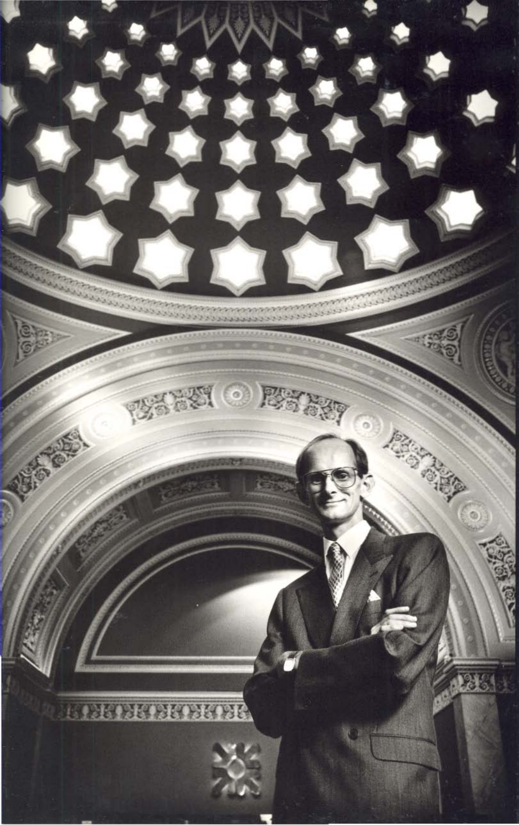
A tall order; one that we have filled with a variety of network-based solutions, including Microsoft SQL Server, a sophisticated, intelligent, network database server. SQL Server is a tool for developing client-server applications that can take advantage of the processing power distributed across organizations.

Over the past 18 months, we've made a major commitment to the electronic-mail market by acquiring the Consumers Software Inc. product line and updating Microsoft Mail, our electronic-mail solution for the Windows operating system designed to link individual departments or work across entire organizations.

And over the next two years, we intend to create affordable workgroup-based networking solutions that are fully integrated with Windows. These solutions will offer services such as file and printer sharing, electronic mail exchange, and scheduling at a workgroup level, as well as the ability to operate with more large-scale networking solutions such as Microsoft LAN Manager.

Ian Meikle, Project Manager, Technology ►
To prepare itself for growth in a united Europe, The Royal Bank of Scotland is implementing several new technologies — including Microsoft Mail — to help it work more efficiently.

This combination of solutions will give our customers a way to answer both their workgroup and their enterprisewide needs.



The Royal Bank of Scotland

"Electronic mail is the key to any office system," notes Ian Meikle of The Royal Bank of Scotland, "because everybody needs to communicate."

Faced with the challenge of introducing an office system at The Royal Bank, Meikle and his team explored a full range of alternatives from mainframe to PC-based solutions. He recommended Microsoft Mail and a full suite of Microsoft applications.

"Now, more than ever, technology is essential to our business," he observes. "For example, our Technology groups in Edinburgh and London need to be in daily contact. Microsoft Mail is the first tool we use to communicate. We've demonstrated that, compared with the telephone, it saves time and is much less disruptive."

Introducing innovation like this isn't new to The Royal Bank. Founded in 1727, they invented such concepts as the overdraft and branch banking, and were the first bank to offer online service to the most widespread branch network in Britain.

In time, as they continue to expand operations, their mail system will need to reach out as well. "With the arrival of the new Europe at the end of 1992," says Meikle, "this is, for us, what 1776 was to the United States. The revolution is just beginning."

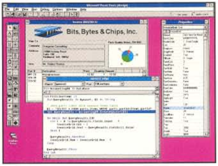
DEVELOPMENT TOOLS

Software, it's said, combines elements of both science and art. Science, because at the core of all products is code that tells the computer what to do and how to do it. Art, because there are no rules that tell you how to combine practical needs with innovative possibilities.

Whenever we set out to create a new product, we always look for alternatives to the entrenched way of doing things.

As the leading developer of personal computer software in the world, we're our own toughest customer, pushing the limits of what's possible with technology. That, in turn, has made us uniquely aware of the challenges faced by both commercial and corporate developers, and has directed the kinds of tools that we create for them.

From our direct experience, as well as from the ongoing conversations we have had with other developers over the past 17 years, we recognize that the best development tools are the ones that give developers maximum flexibility to shape their ideas. Part of that is making development tools that are intelligently designed and as easy as possible to use. Part of it is approaching development in an open way, by building products around industry standards that are widely accessible and predictable.



Microsoft's first product was a version of Basic developed for the MITS Altair, the first personal computer.

While our product line has since expanded into operating systems, applications, hardware, multimedia, consulting services, and beyond, we've never forgotten that we are, first and foremost, a company rooted in the development business. This history gives us a perspective on software development tools unmatched in our industry and an ability to serve our customers like nobody else can.

Microsoft's software development tools include a full line of products, including our flagship Microsoft C/C++ development system for Windows, which is at the heart of many of the commercial software products offered by Microsoft and other companies. We have also aggressively been pursuing options in the database category, both with the internal development of database products as well as our recent merger with Fox Software, a leading supplier of high-end database solutions. We have created software

development kits for Windows and for networking products, and released them to developers months in advance of shipping the actual products. And we have produced the Microsoft Visual Basic™ programming system for Windows, a highly efficient system for creating full-blown Windows-based applications.

Our products, we recognize, are at the heart of how a lot of other companies do business. Our goal—through development tools such as these, through applications and workgroup products, and through Microsoft Windows itself—is to enable the companies we work with to share in our success and to build toward our vision together.

Dorothy Cooney, Director, Aetna Information Technology ►

At the heart of any business success are successful relationships, like the ongoing association crafted by Aetna and Microsoft.

Aetna

"Our relationship with Microsoft goes far beyond just the delivery of technology," explains Dorothy Cooney, Aetna's Director of Information Technology. "It's the support and commitment to making this technology meet Aetna's business objectives. Our joint commitment with Microsoft is important to us; a big part of how we're making quantum leaps in effectively using technology to improve customer service and reduce expenses, while bringing increased order to our technology environment, which all brings bottom-line benefits to our customers, users, and shareholders."

Aetna has established a consistent, standards-based computing environment, called the Consistent Office, which uses Microsoft technology. "Technology diversity causes distraction for application developers and confusion to the user," notes Cooney. "The consistency of Microsoft's technologies provides a focused platform for application development, as well as a more intuitive environment for people to learn and use."

"At Aetna, we talk about our idea of 'One and Done' — a high-quality way to satisfy the broad needs of our customers. Microsoft's Information at Your Fingertips *aligns closely with this vision and provides Aetna with the consistent, easy-to-use, and cost-effective tools to help make it happen."*

M I C R O S O F T C O R P O R A T I O N 1 9 9 2 F I N A N C I A L R E S U L T S

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(In millions)

Net Revenues

	1992	Change	1991	Change	1990
Net revenues	$2,758.7	**50%**	$1,843.4	**56%**	$1,183.4

Software unit volume (as opposed to price) increases have been the principal factor in the Company's revenue growth. Prices for the Company's various products have been relatively stable during the period from 1990 through 1992. Product upgrades, enabling existing users to upgrade from earlier versions of the Company's products or from competitors' products, generally have had lower prices than new products. In 1992, 1991, and 1990, the percentage of the Company's unit sales represented by product upgrades increased each year. Management expects revenues from upgrade products to continue to increase.

The Company's revenues are influenced by many factors, including sales of upgrades, growth in worldwide personal computer sales, the success of the Windows operating system, the release of new products and major new versions of existing products, the sales channel through which new and existing products are sold, expansion of the Company's international operations to new geographic areas, foreign currency fluctuations, price competition, and changes in market share.

The Company's operating results are affected by exchange rates. Sales collectible in foreign currencies represented 46%, 47%, and 39% of total revenues in 1992, 1991, and 1990. The impact of exchange rates on translated net revenues was to reduce net revenues by 1% in 1992 and to increase net revenues by 4% in 1991 and 1% in 1990. As most of the Company's international manufacturing costs and operating expenses are incurred in local currencies, the total impact of exchange rates on net income is less than on revenues.

Product Groups

Systems product group sales were $1,103.5 million, $668.6 million, and $463.8 million in 1992, 1991, and 1990. The Windows operating system was an increasingly strong contributor to systems revenues during the three-year period. More than half of Windows units sold in 1992 were licensed through the original equipment manufacturer (OEM) channel, up from approximately 40% in 1991. The newest version of the product, Windows 3.1, was released April 6, 1992.

Systems revenues generated by the MS-DOS operating system increased in both the OEM and reseller channels during the three-year period. A retail upgrade of MS-DOS, released in June 1991, was a contributor to 1992 revenue growth.

Applications product group revenues were $1,362.5 million, $934.5 million, and $563.0 million in 1992, 1991, and 1990. Increases in applications revenues were led by sales of Windows-based products. New versions of Microsoft Excel, the Company's spreadsheet program, and Microsoft Word, the Company's word processing program, were released in 1992 for Windows and for Macintosh.

Hardware product group revenues were $254.2 million, $213.0 million, and $129.4 million in 1992, 1991, and 1990. The hardware product group's principal products are the Microsoft Mouse and BallPoint mouse pointing devices. Demand for these and competing products is linked to that for the Windows operating system, which is enhanced by using a mouse.

Sales Channels

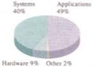
The Company has three major channels of distribution; International, U.S., and OEM. Sales in the International and U.S. channels are to distributors and other resellers and directly to users. OEM channel revenues are license fees from original equipment manufacturers.

Sales through the International channel were $1,309.9 million, $895.6 million, and $492.5 million in 1992, 1991, and 1990. Revenues in Europe grew 45% in 1992 after increasing 90% in 1991.

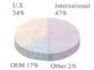
U.S. channel revenues increased to $925.9 million in 1992 from $563.3 million in 1991, an increase of 64%. Revenues in 1991 grew 57% from $358.2 million in 1990.

OEM revenues (primarily operating systems) grew 41% to $476.8 million from the prior year. OEM revenues were $337.4 million in 1991 and $307.1 million in 1990. MS-DOS continues to be preinstalled on most personal computers sold by OEMs. In addition, many major original equipment manufacturers are preinstalling Windows on personal computers, leading to increased revenues through the OEM channel.

Net Revenues Per Employee
(In thousands)



Revenues by Product Group – 1992



Revenues by Sales Channel – 1992

(In millions)

Cost of Revenues

	1992	Change	1991	Change	1990
Cost of revenues	$466.4	**29%**	$362.6	**44%**	$252.7
Percentage of net revenues	16.9%		19.7%		21.4%

Cost of revenues as a percentage of net revenues decreased to 16.9% in 1992 from 19.7% in 1991 and 21.4% in 1990. The lower cost of revenues results from a combination of manufacturing efficiencies, product cost reductions, and increased sales of higher margin applications for Windows. Management does not believe the Company will be able to sustain this rate of improvement in 1993. Factors such as product mix and price competition may cause an increase in cost of revenues as a percentage of net revenues.

Operating Expenses

	1992	Change	1991	Change	1990
Research and development	$352.2	**50%**	$235.4	**30%**	$180.6
Percentage of net revenues	12.8%		12.8%		15.3%
Sales and marketing	$854.5	**60%**	$533.6	**68%**	$317.6
Percentage of net revenues	31.0%		28.9%		26.8%
General and administrative	$ 89.6	**45%**	$ 62.0	**58%**	$ 39.3
Percentage of net revenues	3.2%		3.4%		3.3%

Increases in research and development expenses resulted primarily from planned additions to the Company's software development staff and higher levels of third-party development costs. As of June 30, 1992, the Company employed 3,432 people in product research and development, compared to 2,729 in 1991 and 1,983 in 1990. During 1993, the Company plans to increase its investments in existing products, new software products, new technologies, and pure research.

The increase in sales and marketing expenses has been due to planned hiring of marketing personnel, increased advertising and marketing programs for the launch of new products including television advertising, and further development of Product Support Services. Expansion and increased marketing costs have occurred both domestically and internationally. The Company's sales and marketing expenses in 1993 will include investments in product support, geographic expansion, and channels of distribution.

The increases in general and administrative expenses are primarily attributable to the growth in administrative staff and systems necessary to support overall increases in the scope of the Company's operations.

Nonoperating Income

	1992	Change	1991	Change	1990
Nonoperating income	$45.3	**118%**	$20.8	**20%**	$17.3
Percentage of net revenues	1.6%		1.1%		1.5%

The primary component of nonoperating income is interest income, which was $57.9 million, $41.8 million, and $34.4 million in 1992, 1991, and 1990. Increased interest income is the result of a larger investment portfolio generated by cash from operations, offset in both 1992 and 1991 by declining interest rates. Nonoperating expense did not fluctuate significantly.

Provision for Income Taxes

	1992	Change	1991	Change	1990
Provision for income taxes	$333.2	**60%**	$207.9	**58%**	$131.4
Percentage of net revenues	12.1%		11.3%		11.1%
Effective tax rate	32.0%		31.0%		32.0%

Note 8 to financial statements describes the differences between the U.S. statutory and the effective income tax rates.

In the first quarter of 1994, the Company will be required to follow *Statement of Financial Accounting Standards No. 109—Accounting for Income Taxes.* The Statement is not expected to have a material impact on the financial statements.

Net Income and Net Income Per Share

	1992	Change	1991	Change	1990
Net income	$708.1	**53%**	$462.7	**66%**	$279.2
Percentage of net revenues	25.7%		25.1%		23.6%
Net income per share	$ 2.41	**47%**	$ 1.64	**58%**	$ 1.04

The continued improvement in net income as a percentage of net revenues is primarily attributable to strong revenue growth and reductions in cost of revenues. Management does not expect this trend to continue.

Cost of Revenues

R&D Spending
(In millions)

Net Income as a Percent of Net Revenues

INCOME STATEMENTS

(In thousands, except net income per share)	Year ended June 30		
	1992	1991	1990
Net revenues	$2,758,725	$1,843,432	$1,183,446
Cost of revenues	466,424	362,589	252,668
Gross profit	2,292,301	1,480,843	930,778
Operating expenses:			
Research and development	352,153	235,386	180,615
Sales and marketing	854,537	533,619	317,593
General and administrative	89,632	61,996	39,332
Total operating expenses	1,296,322	831,001	537,540
Operating income	995,979	649,842	393,238
Interest income — net	55,894	37,265	30,837
Nonoperating expense	(10,608)	(16,463)	(13,511)
Income before income taxes	1,041,265	670,644	410,564
Provision for income taxes	333,205	207,901	131,378
Net income	$ 708,060	$ 462,743	$ 279,186
Net income per share	$ 2.41	$ 1.64	$ 1.04
Weighted average shares outstanding	294,218	281,489	268,677

Net Income Per Share

See accompanying notes.

The Company's cash and short-term investments totaled $1,344.9 million at June 30, 1992 and represented 51% of total assets. The portfolio is diversified among security types, industry groups, and individual issuers. The Company's investments are investment grade and liquid.

Microsoft has no material long-term debt. Stockholders' equity at June 30, 1992 was more than $2.1 billion.

Cash generated from operations has been sufficient to fund the Company's investment in research and development activities and facilities expansion. As the Company grows, investments will continue in research and development in new and existing areas of technology. Cash may also be used to acquire technology. Additions to property, plant, and equipment are expected to continue, including new facilities and computer systems for development, sales, marketing, product support, and administrative staff. During 1992, the Company purchased land and four buildings for $47.0 million. These facilities, part of the corporate campus in Redmond, Washington, were previously leased.

The exercise of stock options by employees provides additional cash. Funds received have been used to repurchase the Company's common stock on the open market, which provides shares for stock option and stock purchase plans. This practice will continue in 1993.

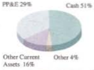
The Company has available $85.0 million of standby multicurrency lines of credit. These lines support foreign currency hedging and international cash management.

Management believes existing cash and short-term investments together with funds generated from operations should be sufficient to meet the Company's operating requirements.

Cash & Short-term Investments
(In millions)

BALANCE SHEETS

(In thousands)	June 30	
	1992	1991
Assets		
Current assets:		
Cash and short-term investments	$1,344,901	$ 686,314
Accounts receivable — net of allowances of $56,715 and $36,283	270,215	243,304
Inventories	85,873	47,106
Other	68,715	51,779
Total current assets	1,769,704	1,028,503
Property, plant, and equipment — net	766,630	530,191
Other assets	103,569	85,490
Total assets	$2,639,903	$1,644,184
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 187,519	$ 85,923
Customer deposits	14,217	25,680
Accrued compensation	62,083	41,643
Notes payable	8,324	19,456
Income taxes payable	73,033	44,445
Other	101,769	76,206
Total current liabilities	446,945	293,353
Commitments and contingencies	—	—
Stockholders' equity:		
Common stock and paid-in capital — shares authorized 500,000; issued and outstanding 272,139 and 261,351	656,855	394,542
Retained earnings	1,536,103	956,289
Total stockholders' equity	2,192,958	1,350,831
Total liabilities and stockholders' equity	$2,639,903	$1,644,184



Assets – 1992

Liabilities & Stockholders' Equity – 1992

See accompanying notes.

STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)	Common Stock and Paid-in Capital			
	Shares	Amount	Retained Earnings	Total Stockholders' Equity
Balance, June 30, 1989	245,637	$110,480	$ 451,300	$ 561,780
Common stock issued	11,973	72,738	—	72,738
Common stock repurchased	(1,786)	(801)	(45,864)	(46,665)
Stock option income tax benefits	—	37,103	—	37,103
Net income	—	—	279,186	279,186
Translation adjustment	—	—	14,421	14,421
Balance, June 30, 1990	255,824	219,520	699,043	918,563
Common stock issued	10,998	94,406	—	94,406
Common stock repurchased	(5,471)	(4,694)	(192,279)	(196,973)
Stock option income tax benefits	—	85,310	—	85,310
Net income	—	—	462,743	462,743
Translation adjustment	—	—	(13,218)	(13,218)
Balance, June 30, 1991	261,351	394,542	956,289	1,350,831
Common stock issued	12,768	135,201	—	135,201
Common stock repurchased	(1,980)	(2,799)	(132,180)	(134,979)
Stock option income tax benefits	—	129,911	—	129,911
Net income	—	—	708,060	708,060
Translation adjustment	—	—	3,934	3,934
Balance, June 30, 1992	272,139	$656,855	$1,536,103	$2,192,958

See accompanying notes.

Stockholders' Equity
(In thousands)

CASH FLOWS STATEMENTS

(In thousands)	Year ended June 30		
	1992	1991	1990
Cash flows from operations			
Net income	$708,060	$462,743	$279,186
Depreciation and amortization	112,321	75,762	46,318
Current liabilities, excluding notes payable	178,080	94,102	44,107
Accounts receivable	(33,382)	(64,878)	(62,233)
Inventories	(39,979)	8,141	(15,630)
Other current assets	(18,121)	(17,992)	(13,474)
Net cash from operations	906,979	557,878	278,274
Cash flows from financing			
Notes payable	(11,132)	12,913	(19,636)
Common stock issued	135,201	94,406	72,738
Common stock repurchased	(134,979)	(196,973)	(46,665)
Stock option income tax benefits	129,911	85,310	37,103
Net cash from financing	119,001	(4,344)	43,540
Cash flows used for investments			
Additions to property, plant, and equipment	(316,642)	(264,395)	(158,090)
Other assets	(40,618)	(39,659)	(18,111)
Short-term investments	(284,320)	(76,621)	(94,519)
Net cash used for investments	(641,580)	(380,675)	(270,720)
Net change in cash and equivalents	384,400	172,859	51,094
Effect of exchange rates	(10,133)	(2,004)	2,834
Cash and equivalents, beginning of year	417,171	246,316	192,388
Cash and equivalents, end of year	$791,438	$417,171	$246,316

Cash from Operations as a Percent of Net Income

See accompanying notes.

Report of Management

Management is responsible for preparing the Company's financial statements and related information that appears in this annual report. Management believes that the financial statements fairly reflect the form and substance of transactions and reasonably present the Company's financial condition and results of operations in conformity with generally accepted accounting principles. Management has included in the Company's financial statements amounts that are based on estimates and judgments, which it believes are reasonable under the circumstances.

The Company maintains a system of internal accounting policies, procedures, and controls intended to provide reasonable assurance, at appropriate cost, that transactions are executed in accordance with Company authorization and are properly recorded and reported in the financial statements, and that assets are adequately safeguarded.

Deloitte & Touche audits the Company's consolidated financial statements in accordance with generally accepted auditing standards and provides an objective, independent review of the fairness of reported financial condition and results of operations.

The Board of Directors of the Company has an Audit Committee composed of nonmanagement Directors. The Committee meets with financial management, the internal auditors, and the independent auditors to review internal accounting controls and accounting, auditing, and financial reporting matters.

Francis J. Gaudette

Francis J. Gaudette
Executive Vice President, Operations;
Chief Financial Officer

Report of Independent Auditors

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying balance sheets of Microsoft Corporation and subsidiaries as of June 30, 1992 and 1991, and the related statements of income, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 1992. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Microsoft Corporation and subsidiaries as of June 30, 1992 and 1991, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1992 in conformity with generally accepted accounting principles.

Deloitte & Touche

Deloitte & Touche
Bellevue, Washington
August 10, 1992

Note 1. Significant Accounting Policies

Business. The Company develops, produces, markets, and supports a wide range of software for business and professional use, including operating systems, languages, and applications, as well as books, hardware, and CD-ROM products for the personal computer marketplace.

Principles of Consolidation. The financial statements include the accounts of Microsoft and its wholly owned subsidiaries. Significant intercompany transactions and balances have been eliminated.

Foreign Currency Translation. Current assets and liabilities denominated in foreign currencies are translated at the exchange rate on the balance sheet date. Property, plant, and equipment and resulting depreciation are translated at historical rates. Revenues, costs, and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are charged or credited to equity. The balance in the cumulative translation adjustment account at June 30, 1992 increased stockholders' equity by $1.0 million.

Realized and unrealized gains and losses on foreign currency transactions and forward hedge contracts are included in nonoperating expense. At June 30, 1992, the Company had approximately $27.9 million of forward hedge contracts outstanding.

Revenue Recognition. Revenue from sales to distributors and other resellers and directly to users is recognized when products are shipped. Revenue from products licensed to original equipment manufacturers is recognized ratably over the license period. License fees received prior to product acceptance are recorded as customer deposits.

Warranties and Returns. The Company warrants products against defects and has policies permitting the return of products under certain circumstances. The Company's reserve for warranties and returns was $41.3 million and $20.9 million at June 30, 1992 and 1991.

Research and Development. Research and development costs are expensed as incurred. Financial accounting rules requiring capitalization of certain software development costs do not materially affect the Company.

Income Taxes. Income tax expense includes U.S. and international income taxes, including U.S. taxes on undistributed earnings of international subsidiaries. Certain items of income and expense are not reported in both the tax returns and financial statements in the same year. The resulting tax difference is reported as deferred income taxes. Tax credits are accounted for as a reduction of tax expense in the year in which the credits reduce taxes payable.

Net Income Per Share. Net income per share is computed on the basis of the weighted average number of common and common equivalent shares outstanding and is adjusted for shares issuable upon exercise of stock options. The computation assumes the proceeds from the exercise of stock options were used to repurchase common shares at the average market price of the Company's common stock during each period.

Stock Split. Effective June 15, 1992, outstanding shares of common stock were split three-for-two. All share and per share amounts have been restated to reflect the stock split.

Cash and Short-term Investments. The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. Short-term investments are stated at the lower of cost or market.

Inventories. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property, Plant, and Equipment. Property, plant, and equipment are stated at cost and depreciated using the straight-line method over the following estimated useful lives:

Buildings	30 years
Leasehold improvements	Lease term
Computer equipment and other	3 – 5 years

Diversification of Credit Risk. The Company's investment portfolio is diversified and consists of short-term investment grade securities. At June 30, 1992 and 1991, approximately 35% and 40% of accounts receivable represented amounts due from ten customers.

Stock Repurchase Program. The Company repurchases its common stock on the open market to provide shares for issuance to employees under stock option and stock purchase plans. The Company's Board of Directors authorized continuation of this program for 1993.

Reclassifications. Certain reclassifications have been made for consistent presentation.

Note 2. Cash and Short-term Investments

(In thousands)	June 30 1992	1991
Cash and equivalents:		
Cash	$ 200,077	$ 44,735
Commercial paper	243,684	205,172
Money market preferreds	144,700	117,600
Certificates of deposit	128,372	14,609
Bank loan participations	74,605	35,055
Cash and equivalents	791,438	417,171
Short-term investments:		
Municipal securities	292,200	168,776
Corporate notes and bonds	125,407	54,976
U.S. Treasury securities	99,595	—
Auction rate preferreds	21,440	25,788
Commercial paper	14,821	19,603
Short-term investments	553,463	269,143
Cash and short-term investments	$1,344,901	$686,314

Note 3. Inventories

(In thousands)	June 30 1992	1991
Raw materials and work in process	$36,057	$15,748
Finished goods	49,816	31,358
Inventories	$85,873	$47,106

Note 4. Property, Plant, and Equipment

(In thousands)	June 30 1992	1991
Land	$142,084	$122,780
Buildings	344,557	203,915
Computer equipment	324,191	221,927
Other	166,367	100,027
Property, plant, and equipment — at cost	977,199	648,649
Accumulated depreciation	(210,569)	(118,458)
Property, plant, and equipment — net	$766,630	$530,191

Note 5. Other Assets

Intellectual Property Rights. Other assets include intellectual property rights of $37.8 million and $20.0 million at June 30, 1992 and 1991. Such amounts are stated at cost less accumulated amortization of $19.5 million and $9.0 million. Amortization expense is provided on the straight-line basis over estimated useful lives ranging from two to five years.

Financial Assets. Other assets also include minority interests in The Santa Cruz Operation, Inc., a UNIX® software company, and Dorling Kindersley Holdings Limited, a publisher in the United Kingdom. Financial assets are carried at cost less a provision for the excess of cost over pro rata equity in the investment. The financial asset provision is included in nonoperating expense.

Note 6. Leases

The Company has operating leases for most international and U.S. field sales and development offices and certain data processing and other equipment. Certain leases provide for rental adjustments based on a consumer price index. Rental expense for operating leases was $43.8 million, $27.5 million, and $17.0 million in 1992, 1991, and 1990. At June 30, 1992, future minimum rental payments under noncancelable operating leases were (in thousands):

Fiscal Year	Minimum Rental Payments
1993	$ 46,930
1994	41,138
1995	35,175
1996	28,432
1997	20,034
1998 and thereafter	70,559
Total minimum payments	$242,268

Note 7. Notes Payable

Notes payable are borrowings under loan agreements with financial institutions, both domestic and abroad. These standby multicurrency lines of credit, which allow borrowings of up to $85.0 million, are maintained principally to facilitate intercompany cash flow and to support foreign currency hedging. The agreements do not require compensating balances or commitment fees.

Note 8. Income Taxes

The income tax provision (benefit) was composed of:

(In thousands)	1992	1991	1990
Current:			
U.S. and state	$224,705	$133,673	$ 87,036
International	112,581	101,761	55,374
	337,286	235,434	142,410
Deferred benefit	(4,081)	(27,533)	(11,032)
Provision for income taxes	$333,205	$207,901	$131,378

Deferred taxes related to timing differences were:

(In thousands)	1992	1991	1990
Undistributed (distributed) international earnings	$ 18,484	$ 2,137	$ (1,296)
Revenues	(12,761)	(11,477)	(2,615)
Cost of revenues	1,760	(7,096)	(6,558)
Expenses	(11,564)	(11,097)	(563)
Deferred income tax benefit	$ (4,081)	$(27,533)	$(11,032)

Differences between the U.S. statutory and effective tax rates were:

	1992	1991	1990
U.S. statutory rate	34.0%	34.0%	34.0%
Tax exempt income	(0.6)	(0.9)	(1.4)
Foreign Sales Corporation	(1.0)	(0.7)	(2.0)
Tax credits	(1.1)	—	(0.8)
Other — net	0.7	(1.4)	2.2
Effective tax rate	32.0%	31.0%	32.0%

U.S. and international components of income before income taxes were:

(In thousands)	1992	1991	1990
U.S.	$ 658,518	$362,398	$238,252
International	382,747	308,246	172,312
Income before income taxes	$1,041,265	$670,644	$410,564

The Internal Revenue Service is examining the Company's U.S. income tax returns for 1989 and 1988. The Company believes that adjustments from the examination will not be material to the financial statements. In 1992, 1991, and 1990, income taxes paid were $174.7 million, $120.7 million, and $82.0 million.

Note 9. Interest Income — Net and Nonoperating Expenses

(In thousands)	1992	1991	1990
Interest income	$ 57,882	$ 41,780	$ 34,426
Interest expense	(1,988)	(4,515)	(3,589)
Interest income — net	$ 55,894	$ 37,265	$ 30,837
Financial asset provision	$ (8,667)	$(10,662)	$ (5,855)
Stock option program expense	—	(3,000)	(6,000)
Other	(1,941)	(2,801)	(1,656)
Nonoperating expense	$(10,608)	$(16,463)	$(13,511)

Note 10. Stockholders' Equity

Merger with Fox Software. In June 1992, the Company merged with Fox Software, a database software publisher, in a pooling of interests. The Company exchanged 2.0 million shares, shown as outstanding at June 30, 1992, for all of the outstanding stock of Fox. Fox assets and liabilities, which were nominal, are included with those of the Company as of June 30, 1992. Operating results for Fox during 1992, 1991, and 1990 were not material to the combined results of the Companies. Accordingly, the financial statements for such periods have not been restated.

Note 11. Employee Stock and Savings Plans

Employee Stock Purchase Plan. The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. During 1992, 1991, and 1990, shares totaling 464,519, 506,038, and 642,447 were issued under the plan at average prices of $49.17, $28.06, and $10.14 per share. At June 30, 1992, 2,641,035 shares were reserved for future issuance.

Savings Plan. The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Under the plan, participating U.S. employees may defer up to 15% of their pre-tax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar contributed by a participant, with a maximum contribution of 3% of a participant's earnings. The Company's matching contributions to the savings plan were $4.9 million, $3.2 million, and $2.4 million in 1992, 1991, and 1990.

Stock Option Plans. The Company has stock option plans for directors, officers, and most employees, which provide for nonqualified and incentive stock options. The Board of Directors determines the option price (not to be less than fair market value for incentive options) at the date of grant. The options generally expire ten years from the date of grant and are exercisable over the period stated in each option. At June 30, 1992, options for 20,375,943 shares were exercisable and 29,262,355 shares were available for future grants under the plans.

Outstanding Options

		Price per Share	
	Number	Range	Weighted Average
Balance, June 30, 1989	50,450,036	$ 0.05 – 13.95	$ 8.99
Granted	19,956,510	11.38 – 32.00	14.75
Exercised	(11,767,739)	0.05 – 13.95	6.13
Canceled	(2,320,179)	0.33 – 17.17	10.87
Balance, June 30, 1990	56,318,628	0.16 – 32.00	11.64
Granted	13,770,737	22.22 – 44.78	29.89
Exercised	(10,823,012)	0.16 – 19.72	8.84
Canceled	(1,767,104)	0.33 – 32.00	11.63
Balance, June 30, 1991	57,499,249	0.61 – 44.78	16.54
Granted	14,870,314	41.17 – 79.58	47.54
Exercised	(10,366,610)	0.61 – 33.22	12.99
Canceled	(1,852,434)	3.00 – 77.67	14.77
Balance, June 30, 1992	60,150,519	0.61 – 79.58	24.87

Note 12. Contingencies

On March 17, 1988, Apple Computer, Inc., brought suit against Microsoft and Hewlett-Packard Company for alleged copyright infringement in the U.S. District Court, Northern District of California. The complaint includes allegations that the visual displays of Microsoft Windows version 2.03 infringe Apple's copyrights and exceed the scope of a 1985 Settlement Agreement between Microsoft and Apple. The complaint seeks to enjoin Microsoft from marketing Microsoft Windows version 2.03 or any derivative work based on Windows 2.03 and from otherwise infringing Apple's copyrights and seeks damages resulting from the alleged infringement. The complaint also alleges that Microsoft is a contributory infringer as to a Hewlett-Packard product called NewWave™.

The Company answered the complaint, denying Apple's allegations that the visual displays in Microsoft Windows version 2.03 infringe any protectible right of Apple, raising affirmative defenses, asserting counterclaims, and seeking damages in an unspecified amount resulting from Apple's actions. In a July 25, 1989 order, the court held that: (1) the use in Windows version 2.03 of visual displays that are in Windows version 1.0 and the named applications programs is licensed under the 1985 Agreement, and (2) the allegedly infringing visual displays used in Windows version 2.03 are in Windows version 1.0, except for seven displays relating to the use of overlapping main application windows and three relating to the appearance and manipulation of icons. This means that 179 of the 189 Windows version 2.03 visual displays that Apple alleges are infringing are covered by the 1985 Agreement.

In a March 6, 1991 order, the court confirmed the elemental approach to the copyright issues but denied Microsoft's motion for a determination that seven of the ten remaining visual displays are licensed by the 1985 Agreement. In a June 14, 1991 order, the court permitted Apple to supplement its complaint to include Windows version 3.0 as an allegedly infringing work. In a July 25, 1991 order, the court dismissed Microsoft's remaining counterclaim, wherein Microsoft alleged that Apple had breached an implied covenant not to sue for infringement as to any visual displays covered by the 1985 Agreement. In an August 13, 1991 order, the court reinstated the defense that some or all of the features in question were not original to Apple, expounded on the "substantial similarity" test as applied to software copyright infringement, and asked for hardware, software, and "instructions necessary to provide the court with a working familiarity with the programs and their operation." The parties provided the court with copies of the products and on October 31, 1991 demonstrated these products for the court. Nonexpert discovery was substantially completed by January 31, 1992 and expert discovery was substantially completed by February 28, 1992.

On February 11, 1992, Microsoft disclosed Apple's written claim for $4.365 billion as damages from Microsoft's alleged infringement of Apple's copyrights. Apple later amended this claim to approximately $5.5 billion and more recently to $4.9 billion. Microsoft considers Apple's damages claim

to be insupportable under the copyright law and speculative. No damages could be awarded without a finding of infringement. Microsoft's belief is that the allegedly infringed material remaining at issue in Apple's works is not copyrightable and that no infringement has occurred.

In an April 14, 1992 order, the court ruled that none of the ten remaining allegedly infringed displays in the Windows version 2.03 case is protectible under Apple's copyrights. The court also ruled that 26 of the allegedly infringing Windows version 3.0 displays are licensed under the 1985 Agreement. At a May 12, 1992 hearing, the judge indicated that, in response to Apple's motion filed on April 24, 1992, he would reconsider the scope of protection decisions in the April 14, 1992 order. Most of the hearing was devoted to demonstrations of the remaining allegedly infringed visual displays in the Windows version 3.0 case and argument on the substantial similarity issues and whether Microsoft could be liable for any infringement by Hewlett-Packard.

A hearing scheduled for June 9, 1992 on Microsoft's pending motions for summary judgment regarding Apple's damages claims and Apple's allegation that Hewlett-Packard is jointly and severally liable for alleged infringement by Microsoft was stricken by the court.

On August 7, 1992, the court entered an order on the issue of whether the allegedly infringed visual displays in Apple's works are within the scope of its copyrights. The court also ruled on Apple's motion for reconsideration. The court determined that the 23 remaining allegedly infringed visual displays claimed by Apple to be in Windows 3.0 are unprotectible by copyright, are licensed under the 1985 Agreement, or are not similar in the accused product. The court affirmed its April 14, 1992 order that none of the ten remaining allegedly infringing Windows 2.03 visual displays is protectible by copyright, with the possible exception of aspects of four of the allegedly infringed visual displays in Apple's works that "could possibly be associated with unlicensed, artistic expression to be compared under a 'virtual identity' standard . . ." The court subsequently directed the parties to file additional papers on the issues that remain to be decided prior to final resolution of the case. These papers will be submitted on August 31, 1992, with reply briefs due on September 14, 1992. The court will then determine if a further hearing is necessary.

In June 1990, Microsoft was notified that it was the subject of a nonpublic investigation being conducted by the staff of the Federal Trade Commission (FTC). During further communications, the Company learned that the staff wished to determine if Microsoft and the IBM Corporation had entered into an alleged anticompetitive horizontal agreement that was purportedly reflected in a joint press release issued at the COMDEX computer trade show in November 1989. Microsoft has substantially completed its production of documents for that phase. The existence of this investigation became public knowledge in March 1991 when some third parties disclosed that the FTC staff had contacted them about the investigation. In April 1991, Microsoft learned that, apparently due to complaints from third parties, the staff had decided to broaden the investigation to examine allegations that the Company has monopolized or has attempted to monopolize the market for operating systems, operating environments, computer software, and peripherals for personal computers. The Company is currently producing documents for this second phase.

The Company presently believes that the resolution of these matters will not have a material adverse effect on its financial condition as reported in the accompanying financial statements.

(In thousands)	Information by Geographic Area				
	U.S. Operations	European Operations	Other International Operations	Eliminations	Consolidated
1992					
Net revenues:					
Customers	$1,492,630	$1,008,545	$257,550	$ —	$2,758,725
Intercompany	384,773	497,874	14,161	(896,808)	—
Total	1,877,403	1,506,419	271,711	(896,808)	2,758,725
Operating income	664,396	329,305	10,553	(8,275)	995,979
Identifiable assets	1,858,156	872,228	288,743	(379,224)	2,639,903
1991					
Net revenues:					
Customers	$ 974,359	$ 697,729	$171,344	$ —	$1,843,432
Intercompany	236,107	326,414	15,626	(578,147)	—
Total	1,210,466	1,024,143	186,970	(578,147)	1,843,432
Operating income	372,630	280,203	11,772	(14,763)	649,842
Identifiable assets	1,278,247	578,572	207,739	(420,374)	1,644,184
1990					
Net revenues:					
Customers	$ 717,630	$ 363,294	$102,522	$ —	$1,183,446
Intercompany	139,827	211,609	19,421	(370,857)	—
Total	857,457	574,903	121,943	(370,857)	1,183,446
Operating income	269,724	148,879	16,716	(42,081)	393,238
Identifiable assets	865,223	364,356	58,806	(183,036)	1,105,349

Intercompany sales between geographic areas are accounted for at prices representative of unaffiliated party transactions. "Other International Operations" primarily include subsidiaries in Australia, Canada, Japan, Korea, and Taiwan. The majority of export revenues results from OEM distribution in the Far East and Europe and finished goods exports to the Far East and South America.

International revenues, which include both international operations and export, were as follows:

(In thousands)	1992	1991	1990
European operations	$1,008,545	$ 697,729	$363,294
Other international operations	257,550	171,344	102,522
Export	254,695	187,734	184,433
	$1,520,790	$1,056,807	$650,249
Percentage of total revenues	55.1%	57.3%	54.9%

QUARTERLY FINANCIAL AND MARKET INFORMATION
(Unaudited)

(In thousands, except per share data)	Quarter ended				
	Sept. 30	Dec. 31	Mar. 31	June 30	Year
1992					
Net revenues	$580,473	$681,865	$680,888	$815,499	$2,758,725
Gross profit	476,024	566,782	570,781	678,714	2,292,301
Net income	143,952	175,240	178,750	210,118	708,060
Net income per share	0.50	0.60	0.60	0.71	2.41
Common stock price per share:					
High	60	74-5/8	88-7/8	86-1/8	88-7/8
Low	40-3/8	57-1/2	73	65-3/4	40-3/8
1991					
Net revenues	$369,405	$460,474	$486,956	$526,597	$1,843,432
Gross profit	293,452	366,810	391,464	429,117	1,480,843
Net income	87,646	112,825	123,822	138,450	462,743
Net income per share	0.32	0.41	0.44	0.48	1.64
Common stock price per share:					
High	35-7/8	34-1/8	50-1/4	52-1/4	52-1/4
Low	22-1/2	23-3/4	32-3/8	42-5/8	22-1/2
1990					
Net revenues	$235,161	$300,431	$310,882	$336,972	$1,183,446
Gross profit	184,402	234,614	244,785	266,977	930,778
Net income	49,588	74,476	75,169	79,953	279,186
Net income per share	0.19	0.28	0.28	0.29	1.04
Common stock price per share:					
High	15-3/8	19-7/8	26	35	35
Low	11-3/8	15-1/8	18-5/8	24-1/4	11-3/8

The Company has not paid cash dividends on its common stock. The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ National Market System under the symbol MSFT. On July 31, 1992, there were 18,262 holders of record of the Company's common stock.

SELECTED FIVE-YEAR FINANCIAL DATA

(In thousands, except employee and per share data)	Year ended June 30				
	1992	1991	1990	1989	1988
For the year					
Net revenues	$2,758,725	$1,843,432	$1,183,446	$803,530	$590,827
Cost of revenues	466,424	362,589	252,668	204,185	148,000
Research and development	352,153	235,386	180,615	110,220	69,776
Sales and marketing	854,537	533,619	317,593	218,997	161,614
General and administrative	89,632	61,996	39,332	27,898	23,990
Operating income	995,979	649,842	393,238	242,230	187,447
Nonoperating income (expense)	45,286	20,802	17,326	8,566	(3,709)
Income before income taxes	1,041,265	670,644	410,564	250,796	183,738
Provision for income taxes	333,205	207,901	131,378	80,258	59,830
Net income	708,060	462,743	279,186	170,538	123,908
At year-end					
Working capital	$1,322,759	$ 735,150	$ 533,104	$310,131	$227,827
Total assets	$2,639,903	$1,644,184	$1,105,349	$720,598	$493,019
Stockholders' equity	$2,192,958	$1,350,831	$ 918,563	$561,780	$375,498
Number of employees	11,542	8,226	5,635	4,037	2,793
Common stock data					
Net income per share	$ 2.41	$ 1.64	$ 1.04	$ 0.67	$ 0.49
Book value per share	$ 8.06	$ 5.17	$ 3.59	$ 2.29	$ 1.55
Cash and short-term investments per share	$ 4.94	$ 2.63	$ 1.76	$ 1.22	$ 0.76
Average common and equivalent shares outstanding	294,218	281,489	268,677	253,103	251,181
Shares outstanding at year-end	272,139	261,351	255,824	245,637	241,484
Key ratios					
Current ratio	4.0	3.5	3.9	3.0	2.9
Return on net revenues	25.7%	25.1%	23.6%	21.2%	21.0%
Return on average total assets	33.1%	33.7%	30.6%	28.1%	31.7%
Return on average stockholders' equity	40.0%	40.8%	37.7%	36.4%	40.3%
Growth percentages — increases					
Net revenues	49.7%	55.8%	47.3%	36.0%	70.8%
Net income	53.0%	65.7%	63.7%	37.6%	72.4%
Net income per share	47.0%	58.3%	54.5%	36.5%	72.1%
Book value per share	55.9%	43.8%	56.9%	47.1%	54.2%

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Annual Meeting
The Annual Meeting of Stockholders will be held on Friday, October 30, 1992, at 8:00 A.M., at the Hyatt Regency Bellevue at Bellevue Place, 900 Bellevue Way N.E., Bellevue, Washington.

Form 10-K
Copies of Microsoft's Annual Report on Form 10-K are available upon written request from the Investor Relations Department, Microsoft Corporation, One Microsoft Way, Redmond, Washington 98052-6399.

Common Stock
Microsoft common stock is traded over the counter on the NASDAQ National Market System (MSFT).

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Stockholder Inquiries
To notify Microsoft of address changes or lost certificates, stockholders can call First Interstate toll-free at (800) 522-6645.

Microsoft is committed to using our own products in the workplace, and we view this technology as an essential element in the success of our Company. A variety of Microsoft products were used in the development of this annual report, including Microsoft Word for Windows, Microsoft Excel for Windows, and Microsoft Bookshelf® for Windows.

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